Mortgagee's Failure to Take Reasonable Care to Sell at Market Value

A recent decision of Stevenson J of the New South Wales Supreme Court provides a timely warning for Queensland mortgagees of their obligations when exercising power of sale. The decision is *Australia and New Zealand Banking Group Ltd v Pola* [2013] NSWSC 1801.

Facts

The Australia and New Zealand Banking Group Ltd ('the Bank') was seeking possession of two rural properties in New South Wales owned by Mr Pola. The Bank was also seeking judgment from Mr Pola for an amount in the order of $2.1 million. Other than a cross-claim in which a set off was propounded, Mr Pola did not deny the Bank's entitlement to the relief sought.

The set off arose from a claim that Mr Pola and his wife made against the Bank arising out of the sale in 2010 by the Bank, as mortgagee exercising power of sale, of another rural property then owned by Mr and Mrs Pola in southern Queensland ('the Property'). Critically, the Property had the benefit of certain water rights including a water allocation that was capable of being traded separately from the Property. Among other submissions, it was argued that the Bank had failed to discharge its obligations under s 85(1) of the *Property Law Act 1974* (Qld). Section 85(1) provides:

> It is the duty of a mortgagee, including as attorney for the mortgagor, or a receiver acting under a power delegated to the receiver by a mortgagee, in the exercise of a power of sale conferred by the instrument of mortgage or by this or any other Act, to take reasonable care to ensure that the property is sold at the market value.

Submissions relevant to s 85(1)

In relation to the alleged breach of s 85(1), it was submitted that the Bank failed in two respects to discharge its statutory duty. Both submissions centred on the water rights enjoyed by the Property.

The first submission related to the particular water allocation which was capable of being traded separately from the Property. The submission made was that the Bank did not comply with the statutory duty by its failure to sell this water allocation separate to the land. Rather, the Bank elected to sell as an aggregation namely in-one-line.

The second submission was based on the Bank's omission, when advertising the Property for sale, to make any reference to the water rights associated with the property and, in particular, to the separate tradability of the particular water allocation referred to above. Although details of the Property's water entitlements were referred to in an information memorandum prepared on behalf of the mortgagee these details did not appear in the advertising material.

Relevantly, the advertisements were headed 'Mortgagee Exercising Power of Sale', referred to the Property as being irrigated and to 'centuries of alluvial flows' and gave details of the water storage capacity on the Property. The advertisements also contained a picture of a crop under irrigation. However, the advertisements did not mention the separately tradeable water allocation, nor a particular water licence (being a licence attached to the Property with significant inherent rights and benefits) or any other water entitlements associated with the Property.

On behalf of the Bank it was said that it would be well known in the market place that an irrigated property would have water entitlements and that water allocation changes that had recently occurred would also be well known in the market. It was also submitted on the Bank's behalf that there was a danger of including too much information in any advertisements for the Property. In this regard, the auctioneer of the property said in cross-examination that he considered the knowledge of the water aspects of the property were well covered in a very broad brush approach in the advertisements. Further, he considered that advertisements were to draw attention and enquiry, rather than provide complete information and that, in fact, the more information you put in an advertisement, generally speaking, the less response you would receive.

Relevant Principles

Stevenson J noted (at [233 and 234]) that it was common ground that, once a breach of s 85 is established, it is not necessary to show a causal link between the particular breach and loss, and that at that point 'the question [is] whether the sale price could be equated with the market value of the property'. Provided it was established that a mortgagee failed to take a step that was reasonably necessary 'to ensure' market price was achieved, it was not necessary to prove that, as a matter of fact, the taking of that step would have ensured market price was achieved. Nor was it necessary for the mortgagor to prove that some identifiable individuals would have offered to purchase, or actually purchased, the property for any particular price had there been no breach of the duty (citing *Sablebrook Pty Ltd v Credit Union Australia Ltd* [2008] QSC 242 at [149] per Applegarth J; *Nixon v Commercial and General Acceptance Ltd* [1980] Qd R 153 at 160 per Sheahan J; *McKean v Maloney* [1988] 1 Qd R 628 at 634–5 per McPherson J).

By analogy to the case law under s 420A of the *Corporations Act 2001* (Cth), which is in similar, although not precisely the same, terms as s 85, Stevenson J noted that where a property has attached to it assets or rights which are potentially valuable but not readily transferable, in order to discharge its duty, the mortgagee must consider and, if necessary, make enquiries and obtain advice on how the property or the benefit of the rights or assets might be passed on to a purchaser; and properly ascertain the market value of the property with and without those rights.

A sale below the estimated market value does not of itself point to the conclusion that reasonable care to ensure the property sold at market value was not taken. However, 'if it is proved that the price obtained is substantially below the true value, that may be some evidence that proper steps were not taken' (*Stone v Farrow Mortgage Services (in liq)* [1999] NSWCA 435 at [4], cited with approval in *Stockl v Rigura Pty Ltd* [2004] NSWCA 73 at [32]).

Stevenson J went on to note (at [243]) that the vice in inadequate or defective advertising will not necessarily be cured by the fact that the mortgagee's entire marketing process included additional information available from the agent that correctly disclosed the position. A potential buyer who was relevantly misled, and who would have had to make further enquiries in order to ascertain the correct position, may well have been dissuaded from doing so by the defective advertising.

Result

The Polas' first submission, relating to the separate sale of the water allocation capable of being traded, was not successful. Stevenson J held (at [309] and [310]) that had the Bank given further consideration to the separate sale of this particular water allocation, and sought the opinion of an expert in the water allocation market, it would have received advice that

would have justified it in not pursuing the option further. Thus, the failure by the Bank to take the course advocated on behalf of Mr and Mrs Pola would have made no difference to the ultimate marketing and sale approach taken by the Bank and did not amount to a breach by the Bank of its duty under s 85.

The Polas' second submission, based on the omission in the advertisements, was successful. Stevenson J was prepared to concede (at [327]) that a reader of an advertisement considering the purchase of a very large and expensive farming property on which there is irrigation in all probability would assume the Property enjoyed water entitlements. However, Stevenson J went on to opine (at [328]), that a prospective buyer, looking about in the market, considering a number of possibilities, and weighing up whether to consider purchasing the Property, rather than another property, may well have been tempted to investigate further, had details of the water entitlements featured in the advertisements. Conversely, such a prospective buyer may well have been deterred or deflected from further consideration of the Property in the absence of those details.

Stevenson further noted (at [329] and [330]) that Mr and Mrs Pola did not have to prove that, as a matter of fact, the absence of any reference to the water entitlements made any difference to any particular buyer. All they needed to establish was that inclusion of such details was a step that ought reasonably to have been taken to ensure achievement of market value.

Stevenson J considered that it was obvious that a step, or an act, that ought reasonably to have been done in this case in order to ensure that the Property sold at market value was to emphasise (amongst other things) its water entitlements. As the Bank, through its agents, did not take this step, the Bank was in breach of its duty under s 85.

Having found that the Bank had breached its duty under s 85, Stevenson J held that Mr and Mrs Pola were entitled to damages representing the difference between the price achieved following auction by the Bank ($6.1 million) and the market value of the Property. The expert valuation evidence accepted by Stevenson J valued the property at the date the Bank entered the contract as being $7 million on an in-one-line basis.

On this basis, Mr and Mrs Pola were held to be entitled to damages against the Bank for the difference of $900,000.

Comment

This decision reinforces an observation made elsewhere that the obligations of a mortgagee exercising power of sale in Queensland are process-based.[1] A mortgagee who fails to advertise an important feature of the property offered for sale is likely, as in this instance, to have failed to take a necessary step to satisfy the statutory duty imposed by s 85 of the *Property Law Act 1974* (Qld). The fact that the information may be available elsewhere in a sales package or information memorandum may not be sufficient to excuse non-compliance. Once the statutory duty is found to have been breached, it is not necessary for the mortgagor to prove that the defective advertising made any difference to any particular buyer. Once breach of the statutory duty is established, the measure of damages will be determined by a comparison of the price obtained with expert valuation evidence of the market value of the mortgaged property.

[1] WD Duncan and WM Dixon, *The Law of Real Property Mortgages*, Federation Press, 2nd ed, 2013, 276.

Beyond its immediate application, this case also serves to call into question certain practices that seem to remain prevalent in the wider marketplace. In this regard, it is not uncommon for a mortgagee, when exercising power of sale, to contract on an 'as is where is' basis and to evince the attitude that it is up to a potential buyer to find out about the mortgaged property and its attributes and features. Consistent with this approach, mortgagees have traditionally been somewhat disinclined to undertake searches prior to exercising power of sale. There is grave reason to question such an approach particularly where searches may reveal attractive attributes of the property that should be actively marketed. As this decision clearly illustrates, a failure to market the property in an appropriate manner creates the potential for a significant claim for damages. It is also worth noting that this type of damages claim is not restricted to the mortgagor but may be pursued by an affected guarantor as a 'person damnified by the breach' within the meaning of s 85(3) of the *Property Law Act 1974* (Qld) as previously interpreted by the Queensland courts.[2]

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[2] See, eg, *Higton Enterprises Pty Ltd v BFC Finance Ltd* [1997] 1 Qd R 168.